In the Supreme Court of the United States

OCTOBER TERM, 1974

No. 74-121

CRAIG PHELPS, RECEIVER IN BANKRUPTCY OF CHICAGOLAND IDEEL CLEANERS, INC., BANKRUPT, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES

OPINION BELOW

The opinion of the court of appeals (Pet. App. A) is reported at 495 F. 2d 1283.

JURISDICTION

The judgment of the court of appeals (Pet. App. B) was entered on May 7, 1974. A timely petition for rehearing was denied on May 24, 1974. The petition for a writ of certiorari was filed on August 14, 1974. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether a bankruptcy court has summary jurisdiction to order the collection of an assignee's liability to a bankrupt taxpayer where, prior to bankruptcy, the Internal

Revenue Service had served the assignee with a notice of levy with respect to that liability and had made demand for payment pursuant thereto.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of Sections 2a(21) and 67c(3) of the Bankruptcy Act, as amended, 11 U.S.C. 11(a)(21) and 107(c)(3), and Sections 6321 and 6331 of the Internal Revenue Code of 1954, 26 U.S.C. 6321 and 6331, are set forth at Pet. App. D.

Section 6332 of the Internal Revenue Code of 1954, as amended, 26 U.S.C. 6332, in pertinent part provides:

> (a) * * * [A]ny person in possession of (or obligated with respect to) property or rights to property subject to levy upon which a levy has been made shall, upon demand of the Secretary or his delegate, surrender such property or rights (or discharge such obligation) to the Secretary or his delegate * * *.
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> (c)(1) Any person who fails or refuses to surrender any property or rights to property, subject to levy, upon demand by the Secretary or his delegate, shall be liable in his own person and estate to the United States in a sum equal to the value of the property or rights not so surrendered * * *.
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> (d) Any person in possession of (or obligated with respect to) property or rights to property subject to levy upon which a levy has been made who, upon demand by the Secretary or his delegate, surrenders such property or rights to property (or discharges

such obligation) to the Secretary or his delegate * * * shall be discharged from any obligation or liability to the delinquent taxpayer with respect to such property or rights to property arising from such surrender or payment. * * *

Section 301.6331-1(a)(1) of the Treasury Regulations on Procedure and Administration, 26 C.F.R. 301.6331-1(a)(1), in pertinent part provides:

> If any person liable to pay any tax neglects or refuses to pay such tax within 10 days after notice and demand, the district director to whom the assessment is charged * * * may proceed to collect the tax by levy upon any property, or rights to property, whether real or personal, tangible or intangible, either belonging to such person or with respect to which there is a lien provided by section 6321 or 6324 * * * for the payment of such tax. * * * Property subject to a Federal tax lien which has been sold or otherwise transferred by the taxpayer may be seized while in the hand of the transferee * * *. Levy may be made by serving a notice of levy on any person in possession of, or obligated with respect to, property or rights to property subject to levy including receivables, bank accounts, evidences of debt, securities, and accrued salaries, wages, commissions, and other compensation. * * *

STATEMENT

During the spring of 1971, the Internal Revenue Service made assessments against Chicagoland Ideel Cleaners, Inc., of federal income and social security withholding taxes, and federal unemployment taxes, in the total

amount of $140,831.59.[1] Chicagoland subsequently assigned all its assets to an individual, Nathan Yorke, for the benefit of its creditors. Yorke liquidated the assets and held the proceeds. The Service then filed notice of a federal tax lien for the taxes previously assessed, served Yorke with a notice of levy, and demanded payment.

Shortly thereafter, an involuntary petition in bankruptcy was filed against Chicagoland. A receiver was appointed and Chicagoland was adjudicated bankrupt. The receiver then filed an application with the referee for an order requiring Yorke, who had not yet complied with the Service's demand for payment, to turn over the proceeds from the sale of Chicagoland's assets. The referee ordered the funds turned over to the receiver and the district court affirmed. The court of appeals reversed (Pet. App. A), holding that the levy had transferred possessory interest in the funds from Chicagoland to the United States and therefore that the bankruptcy court lacked summary jurisdiction to order the funds paid over to the receiver.

DISCUSSION

1. a. A bankruptcy court may order property turned over to the receiver only if the court has summary jurisdiction to adjudicate the underlying controversy between the receiver and the adverse claimant to that property; a turnover order may not issue where the claimant is entitled to have his claim adjudicated in a plenary action. See generally 2 Collier, *Bankruptcy*, para. 23.10 (14th ed.), and cases there cited.

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[1]The assessment gave rise to tax liens against all Chicagoland's property and rights to property. See Section 6321 of the Internal Revenue Code of 1954, 26 U.S.C. 6321. These liens were perfected by the subsequent filing of a notice of tax lien. See Section 6323 of the Code.

The general principles governing the scope of a bankruptcy court's summary jurisdiction over controversies between claimants and the trustee or receiver regarding property claimed to be part of the estate have been succinctly stated as follows:

> Generally speaking, where the controversy is one concerning property in the actual or constructive possession of the bankruptcy court, that court may adjudicate summarily all rights and claims pertaining thereto. Where the controversy is one involving property in the actual or constructive possession of a third person asserting a *bona fide* adverse claim, the bankruptcy court has no jurisdiction to determine summarily that person's claim upon petition by the receiver or trustee, unless by that person's consent. [2 Collier, *supra*, para. 23.04[2].]

A third person asserting a *bona fide* adverse claim is accordingly entitled to have his claims against property in his actual or constructive possession adjudicated in a plenary action. 2 Collier, *supra*, para. 23.06. That property is not subject to turnover.

The question before the courts below, therefore, was whether the service of the notice of levy with respect to Yorke's obligation as assignee transferred constructive possession of that obligation from Chicagoland to the United States for the purposes of the Bankruptcy Act. The court of appeals correctly determined that the notice of levy did have that effect.

b. Section 6331 of the Code provides that "[i]f any person liable to pay any tax neglects or refuses to pay the same within 10 days after notice and demand, * * * the Secretary * * * [may] collect such tax * * * by levy upon all property and rights to property * * *belonging

to such person or on which there is a lien * * * for the payment of such tax." Tangible property in the taxpayer's possession is of course subject to levy by physical seizure. But levy need not, and in many cases cannot, take the form of physical seizure when the asset in question is the taxpayer's right to payment from a third person. For that reason, the Treasury Regulations provide that "[l]evy may be made by serving a notice of levy on any person in possession of, or obligated with respect to, property or rights to property subject to levy including receivables, bank accounts, evidences of debt, securities, and accrued salaries, wages, commissions, and other compensation." 26 C.F.R. 301.6331-1(a)(1).

The legal consequence of the service of notice of levy was to transfer effective ownership of Yorke's obligation from Chicagoland to the United States. See Section 6332 of the Code. Yorke's failure or refusal to make payment of the funds to the United States after demand, if persisted in, would subject him to personal liability for "a sum equal to the value of the property or rights not so surrendered." Section 6332(c)(1) of the Code. Thus upon levy and demand the United States, and not the taxpayer, becomes the primary obligee and holds constructive possession of the right to payment.

For these reasons, most courts of appeals that have considered the question have concluded that a bankruptcy court may not, in the absence of the government's consent, order the collection of a liability with respect to which levy and demand had already been made. See *Rosenblum* v. *United States*, 300 F. 2d 843 (C.A. 1); *United States* v. *Eiland*, 223 F. 2d 118 (C.A. 4). Cf. *United States* v. *Pittman*, 449 F. 2d 623 (C.A. 7); *In re Brewster-Raymond Co.*, 344 F. 2d 903 (C.A. 6). There is, however, an acknowledged conflict among the

courts of appeals. The Ninth Circuit, in *In re United General Wood Products Corp.*, 483 F. 2d 975, held that bankruptcy courts have summary jurisdiction to order payment of the amount of the liability to the receiver or trustee in such circumstances. We believe that this conflict should be resolved.

c. The question presented here is important to the administration of the internal revenue laws. Service of notice of levy with respect to a taxpayer's rights to property is often used as a means of enforcing collection of taxes. This is, for example, a common means of reaching a taxpayer's bank accounts. The current conflict among the courts of appeals means that the Internal Revenue Service lacks authoritative guidance as to whether it may rely upon such a levy in circumstances where the taxpayer is suspected of being in precarious financial straits.

2. In addition to the above question, which is comprehended by petitioner's first three questions presented (see Pet. 2), petitioner contends (Pet. 9) that in opposing the turnover order the government is required to carry the burden of coming forward with evidence that it had satisfied the statutory requirements of notice and demand (see Section 6331(a) of the Code) before it served the notice of levy. In rejecting that contention the court of appeals properly noted (Pet. App. A, pp. 2a-3a; footnote omitted):

> The notice of tax lien and the notice of levy both recite that the taxes remained unpaid after demand. These notices are regular on their face. Where, as here, the receiver has not come forward with any evidence suggesting that demands were not made, we will accept the recitations in the notices.

Petitioner cites no basis for his contention and we see none. It is insubstantial and warrants no further review.

CONCLUSION

For the foregoing reasons, we do not oppose the granting of the petition for a writ of certiorari, limited to the first three questions presented.

Respectfully submitted.

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